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ABSTRACT

The federal government enacted the Taxpayer Relief Act in 1997. Whereas other federal student aid programs have used grants, scholarships, and loans to help students and their families finance college, the new law has made college more affordable by providing new federal income tax credits, savings incentives, and deductions for interest paid on student loans. This policy guide examines the implications of these federal tax provisions for state higher education policy. It describes federal tax credits designed to help students and their families to meet the current expenses of college: the HOPE Scholarship and Lifetime Learning tax credits, the new tax incentives concerning college savings, and the new provisions regarding student loans. The second section of the guide describes several state policy options in response to the new federal tax credits, while section three makes recommendations regarding state policy. (Contains 28 references.) (JM)

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FEDERAL TUITION TAX CREDITS AND STATE HIGHER EDUCATION POLICY

December 1998

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Federal Tuition Tax Credits And State Higher Education Policy

A Guide for State Policy Makers

By Kristin D. Conklin

December 1998

A Report from
The National Center for Public Policy and Higher Education

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Preface

In the wake of the new Taxpayer Relief Act, the National Center for Public Policy and Higher Education has prepared this policy guide to help provide a foundation for state policy discussions about financing higher education. This new federal legislation affords states a unique opportunity to review current higher education finance policies. In responding to the federal initiative, each state should determine the extent and nature of unmet needs, and, if necessary, re-align state dollars with current and prospective public priorities.

On the downside, the federal tax credits create the potential for states to reduce their support of higher education by raising tuition or reducing state financial aid, and shifting the costs to the federal government. Although the new legislation is intended to increase overall public support, there are no assurances that dollars captured by states in this way would necessarily be directed to higher education's needs. And if states in the short term resist raising tuition in response to the new federal tax credits, the temptation to do so will resurface during the next economic downturn. For the past quarter century, even without the incentive of federal tax credits, states have shifted costs to students when state revenues have declined. Whatever policies each state chooses to pursue after considering the impact of the tax credits, the ultimate result should serve the goal of enhanced higher education opportunity.

This report was written by Kristin D. Conklin, Director of the National Center's Washington Office. The National Center wishes to thank the following people who served on an advisory committee for the project, and whose suggestions and comments were valuable throughout the project: Julie Davis Bell, Program Director with the National Conference of State Legislatures; David Breneman, University Professor and Dean at the Curry School of Education at the University of Virginia; and William Pickens, Director of the California Citizens Commission on Higher Education. Jonathan Brown, Lawrence E. Gladieux, Hal Hovey, David Shreve, James B. Stedman, and the State Higher Education Financial Officers provided invaluable reviews of previous drafts. Arthur M. Hauptman, an independent consultant affiliated with RAND, contributed important ideas, background materials and analysis. The editorial assistance of Thad Nodine is gratefully acknowledged.

The National Center encourages discussion and debate about the analysis and policy recommendations raised in this policy guide.

Joni E. Finney
Vice President
National Center for Public Policy and Higher Education

Introduction

In 1997 the federal government, by enacting the Taxpayer Relief Act, inaugurated a systemic change in the way it supports students in their postsecondary education and training. Whereas other federal student aid programs use grants, scholarships and loans to help students and their families finance college, the new law makes college more affordable by providing new federal income tax credits, savings incentives, and deductions for interest paid on student loans. Taken together, these federal income tax policies represent one of the largest efforts in recent history to finance college attendance in the United States. Their cost to the federal government—once all the credits, incentives, and deductions are fully used by taxpayers—is projected to approximately equal the cost of *all other existing federal financial aid programs combined.*

This policy guide examines the implications of these federal tax provisions for state higher education policy. It describes the two federal tax credits designed to help students and their families meet the current expenses of college: the HOPE Scholarship and Lifetime Learning tax credits. This guide also explains the new tax incentives concerning college savings, and the new provisions regarding student loans.

Section one describes the existing federal student aid programs and the federal tuition tax provisions, which eligible students and their families can begin claiming in 1998. It also identifies which students will be eligible, based on family income, age, and state of residence. Section two describes several state policy options in response to the new federal tax credits. Section three makes recommendations regarding state policy. Analytic and comparative tables are located in an appendix.

SECTION ONE

The New Federal Income Tax Provisions Regarding Postsecondary Education

A. OVERVIEW

For the past two decades, tuition and fees at private and public colleges and universities have increased more than twice as fast as inflation and roughly 50 percent faster than family incomes. To help relieve some of the burden of these escalating college costs, President Clinton made tuition tax credits a centerpiece of his 1996 re-election campaign. Soon after that election, the 105th Congress modified and expanded the Clinton plan, enacting several tuition tax provisions in the Taxpayer Relief Act of 1997.

This new law—in effect as of January 1998—provides to eligible students and, in many cases, their families, an array of federal income tax benefits, including tax credits, incentives for college savings, and a deduction for interest on student loans. In 1998, the U.S. Department of Education projects the credits to cost the federal government about $9 billion in foregone revenues. This annual cost is expected to increase over the next several years as more taxpayers take advantage of the provisions. From 1998 to 2002, the credits are projected to total about $40 billion.

The features of the new tax provisions are described below.

1. New Federal Income Tax Credits

HOPE Scholarship Tax Credit. Students who are enrolled at least half-time in their first two years of college are eligible for up to a 100% federal income tax credit on the first $1,000 of their tuition and required fees, plus up to a 50% credit on the second $1,000. The tax credit cannot exceed the amount of tuition and required fees *minus* the amount of funding received as grants, scholarships, or other tax-free educational assistance. The tax credit is available to eligible students who file their own federal taxes, or to families who claim an eligible student as a dependent. Those students or families whose incomes are too low to pay federal income taxes would not receive any benefit (see Table A). The tax credit is phased out for upper income earners (see Table A).

Table A

Overview of Income Eligibility for the HOPE Tax Credit

	Dependent Students in a Family of Four	*Single Independent Students*	*Dependent and Independent Students Filing Jointly*	*Filing Singly*
Income too low for any benefits	less than $17,500	less than $6,800		
Income too low for full benefits	$17,500–$27,500	$6,800–$16,800		
Income too high for full benefits			$80,000–$100,000	$40,000–$50,000
Income too high for any benefits			above $100,000	above $50,000

Source: IRS Form 1070 (1997) and IRS Publication 970 (1998)

Lifetime Learning Tax Credit. Students who are enrolled past their first two years of college or who are enrolled less than half-time are eligible for up to a 20% federal income tax credit on the first $5,000 of tuition expenses paid each year through 2002. After 2002, the $5,000 amount will increase to $10,000. As with the HOPE Scholarship, the Lifetime Learning tax credit cannot exceed the amount of tuition and required fees *minus* all funding received as grants, scholarships, or other tax-free educational assistance. The credit is available to eligible students who file their taxes independently, or to families who claim an eligible student as a dependent. Like the HOPE Scholarship, those students or families whose incomes are too low to pay federal income taxes would not receive any benefit (see Table B). The Lifetime Learning tax credit is phased out for upper income earners at the same levels as the HOPE Scholarship (see Table B).

Table B

Overview of Income Eligibility for the Lifetime Learning Tax Credit (1998–2002)

	Dependent Students in a Family of Four	*Single Independent Students*	*Dependent and Independent Students Filing Jointly*	*Filing Singly*
Income too low for any benefits	less than $17,500	less than $6,800		
Income too low for full benefits	$17,500–$24,100	$6,800–$13,450		
Income too high for full benefits			$80,000–$100,000	$40,000–$50,000
Income too high for any benefits			above $100,000	above $50,000

Source: IRS Form 1070 (1997) and IRS Publication 970 (1998)

2. New Federal Income Tax Incentives for College Savings

Education IRA. For each dependent child under age 18, families may deposit up to $500 per year into an Education Individual Retirement Account (IRA). Contributions to Education IRAs are not deductible from federal income taxes, but interest earnings are exempt from taxation, and withdrawals are excluded from the beneficiary's gross income if used for qualifying higher education expenses. Those wishing to contribute to an Education IRA must meet the income

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requirements listed in Table C. Students who receive tax-free distributions from Education IRAs may not, in the same year, receive the HOPE or Lifetime Learning tax credits.

Table C

Overview of Income Eligibility for Education IRA and Student Loan Interest Deduction

	Education IRA		Student Loan Interest Deduction	
	Filing Jointly	*Filing Singly*	*Filing Jointly*	*Filing Singly*
Income too high for full benefits	$150,000–$160,000	$95,000–$110,000	$60,000–$75,000	$40,000–$55,000
Income too high for any benefits	above $160,000	above $110,000	above $75,000	above $55,000

Source: IRS Form 1070 (1997) and IRS Publication 970 (1998).

IRA Withdrawals. Funds may be withdrawn from regular existing IRAs for the postsecondary education expenses of the taxpayer, spouse, child, or grandchild. In these cases, the individual withdrawing the funds will owe income tax on at least part of the distribution, but will not have to pay the 10% tax on early withdrawals.

Prepaid Tuition Plans. Under the new law, families can now use their state-sponsored tuition savings programs to save for the costs of room and board. Interest earned on savings continues to be federally tax-free (as it has been since 1996). Students and families using funds from these plans are also eligible for the HOPE and Lifetime Learning tax credits.

3. New Federal Income Tax Provisions Regarding Student Loans

Student Loan Interest Deduction. The new law allows students or their families to take a federal income tax deduction for interest paid in the first 60 months of repayment on student loans, regardless of whether they itemize their other deductions. The maximum deduction is $1,000 in 1998, $1,500 in 1999, $2,000 in 2000, and $2,500 in 2001 and beyond. To be eligible for the interest deduction, taxpayers must meet the income requirements listed in Table C.

Student Loan Forgiveness. Tax-exempt charitable or educational institutions sometimes forgive all or part of student loan debts for students who meet certain criteria. In the past, the amount of loan forgiveness was federally taxable for the student as a gift. Under the new law, the amount of loan forgiveness is not taxable for those students who take community service jobs that address unmet community needs and who have part or all of their loans forgiven by a tax-exempt charitable or educational institution.

B. Existing Federal Student Aid Programs

With few exceptions, students who qualify for the new tax credits must be enrolled at colleges eligible to participate in existing federal student aid programs, which are listed below.

Pell Grants and Supplemental Educational Opportunity Grants. These need-based grants are awarded to students and do not need to be repaid. President Clinton and Congress also increased the maximum Pell grant award and the number of low income and independent students who could receive Pell grants in 1997. The Pell grant maximum was increased to $3,000—a $300 increase over the 1996 level. The Pell grant program was also increased by $400 million to expand eligibility for independent students and dependent students who work.

Subsidized Student Loans. These loans, which are awarded on the basis of income, must be repaid, but the government pays the interest while the student is in school and for six months after graduation.

Unsubsidized Student Loans. These loans are available regardless of need and are offered to students at a lower interest rate than most loans available in the private market.

The primary beneficiaries of the new federal income tax provisions are middle and upper-middle income families.

C. Which Students Benefit from the New Tax Provisions?

1. Family Income

The primary beneficiaries of the new federal income tax provisions are middle and upper-middle income families, as described below.

1.a. HOPE and Lifetime Learning Tax Credits

Middle and upper-middle income students and their families benefit most.

The new tax credits provide a reduction in federal taxes to eligible students (or to the families of dependent eligible students). Students or their families can benefit from the tax credits to the extent that they owe taxes at all. Lower income students (or their families) who owe no federal taxes do not benefit from the new tax credits. Dependent students whose families have tax bills that are less than the credit receive partial tax credit, equal to the

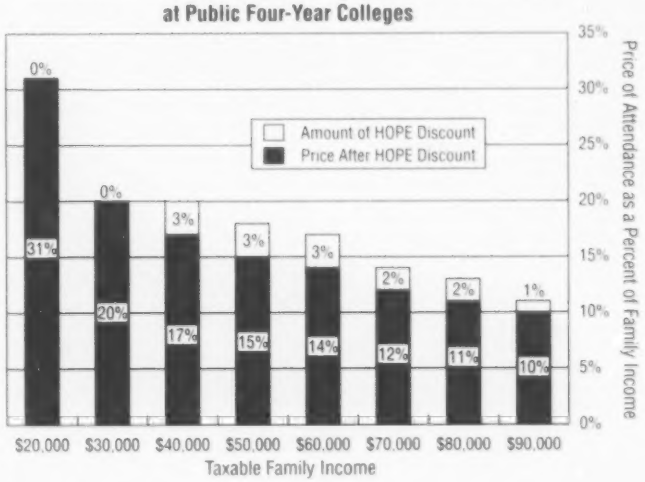
amount they would have owed in taxes. For example, a dependent student from a family of four with two parents filing jointly and a 1997 taxable income of $20,000 is not eligible for the full tax credit, since their tax burden is not high enough to qualify for the maximum allowable credit (see Appendix, Table 3). At the other end of the scale, the tax credits are phased out for high income earners.

Table 4 shows how families and students at different income levels can use federal student aid programs to help pay for college. In general, families who qualify for need-based support (through the Pell grant and loan subsidies) cannot receive the maximum tax credit from the HOPE Scholarship. For instance, a family with a student in a public community college and with a taxable income of $40,000 or less is not eligible for the maximum HOPE tax credit. Similarly, a family with a student in a four-year public college and with a taxable income of $30,000 or less will not receive the maximum HOPE tax credit.

Figure 1 illustrates that for families with taxable incomes from $40,000 to $90,000 a year, the HOPE tax credit reduces the burden of sending a child to a four-year public college or university. Families in these income ranges will find that the HOPE tax credit reduces (by 1% to 3%) the percentage of their income needed to pay for a four-year public college, including tuition, fees, and room and board expenses. In contrast, families earning $30,000 a year or less will not benefit from the tuition tax credits. Figure 1 also displays the percentage of family income required to pay for attendance at four-year public colleges, by income level. For families with taxable family incomes of $10,000 (not shown in Figure 1), the price of attendance at four-year public colleges requires, on average, about 61% of their annual income.

Figure 1

Estimated Effect of HOPE Tax Credit on Price of Attendance at Public Four-Year Colleges



Source: The Brookings Institution

Students at higher priced institutions benefit more than students at lower priced institutions.

This occurs for two reasons. First, students at public community colleges can get some or all of their tuition and fees paid by federal need-based Pell grants.

Only community college students with family incomes between $50,000 and $80,000 are eligible for the maximum HOPE tax credit; students with family incomes of about $40,000 per year receive a partial credit (see Table 4). Comparatively, students attending more expensive private four-year colleges can receive the maximum HOPE tax credit when their family income falls between $30,000 and $80,000 because the Pell grant pays only a fraction of the more expensive tuition and fees. Secondly, lower priced community colleges enroll a higher number of students with incomes too low to qualify for the tax credit. Over the last 15 years, in fact, the percentage of lower income students attending community colleges has increased. In 1994, between one-third and one-half of all college students whose families made $30,000 or less attended a public community college. As Table 4 indicates, community college students who receive Pell grants and loan subsidies and whose families make $30,000 or less are not eligible to receive any tax credit.

1.b. Savings Provisions

Many of the same students eligible for the HOPE and Lifetime Learning tax credits are also most likely to participate in the new savings programs.

Findings from an August 1995 U.S. General Accounting Office study of state prepaid tuition programs showed that these plans most benefit middle and upper income families. In Kentucky, 61% of the participating families had incomes higher than $50,000, while only 10% of participants were from families with incomes under $25,000. In Florida, 51% of the participating families had incomes above $100,000, and another third had incomes between $50,000 and $100,000; only 5% of participants were from families with incomes less than $25,000. In Alabama, almost 60% of participants had family incomes above $50,000, while only 10% had incomes below $25,000. In Texas, half of the participants were in the $50,000 to $100,000 range, with just 5% under $25,000.[1]

1.c. Student Loan Interest Deduction

Families at all income levels will benefit from this provision.

The U.S. General Accounting Office reported earlier this year that students whose family incomes are below $45,000 are two and a half times more

likely to borrow than students whose family income falls between $60,000 and $100,000. This suggests that students from families with lower incomes will be affected by the student loan interest deduction allowable under the new law. On the other hand, students with higher incomes tend to borrow more; their large interest payments would qualify them to file for larger income tax deductions.[2]

2. Age of the Student

Traditional college-age students (ages 18 to 24) and their families are the primary beneficiaries of the HOPE Scholarship and Lifetime Learning tax credits. This is because younger students tend to be dependent and tend to rely on their family's incomes to help pay for college. In 1995–96, the average dependent student was 20 years old. In comparison, independent students, who are on average 33 years old, tend to pay for college with their own incomes. Even though independent students qualify for the HOPE tax credit at lower income levels than dependent students, they are still less likely to be eligible for some or all of the tax credits. Based on income data from 1995–96, 47% of independent undergraduates would be ineligible for any tax credit, compared to 26% of dependent undergraduates.

Although the federal income tax credits flow directly to individuals and families, they have significant implications for state higher education finance.

D. How Does Eligibility for the Tax Credits Vary by State?

Although the federal income tax credits flow directly to individuals and families, they have significant implications for state higher education finance. In 1998, California's students and families are projected to receive $1.2 billion in HOPE and Lifetime Learning tax credits, which represents the highest state total. California's students and families received $785 million in 1995–96 for *all other federal financial aid combined* (including Pell grants, state student incentive grants, and guaranteed student loan subsidies). Alaska's students and families are projected to receive $19 million in tuition tax credits in 1998, which represents the lowest state total. Alaska's students and families received $4.6 million in 1995–96 for other federal financial aid.[3]

The total amount of tax credits received by the residents of a particular state depends on:

- the income levels of college students and their families in that state,
- the distribution of students among lower and higher priced institutions,
- the effects of state-sponsored financial aid, and

- the number of college students or their families who file federal income taxes.

In general, states with a relatively large proportion of low income students enrolled in college will have fewer students and families claiming the maximum tax credit. States that rely heavily on higher priced public and private colleges and universities are likely to have more students and families claiming the maximum tax credit. States that send a large number of students out-of-state will also tend to have more families claiming the maximum tax credit, because the credit is based on the taxpayer's—not the dependent student's—residence, and those taxpayers sending students out of state tend to pay higher tuition, thereby qualifying them for the full tax credit. Finally, states with large student financial aid programs of their own will find that residents at some income levels will not qualify for the full federal tax credit if those residents receive state student financial aid. This is because the amount of the tax credit received by each individual is based on tuition and required fees *minus all grants and scholarships*. Because of this dollar decrease in the federal tax credit for every dollar an individual receives from state grant sources, those states providing significant state grants and scholarships will find that fewer of their residents will qualify for the full federal tax credit.[4]

Since each state has a unique blend of the above characteristics, the effects of the HOPE and Lifetime Learning tax credits will vary significantly by state. The following examples are derived from Table 2 (see Appendix).

Illinois. Illinois has one of the highest rates of students attending college out-of-state. In addition, tuition and fees at Illinois' public four-year colleges are above the national average. These factors help to explain why about 4% of Illinois' students are projected to be ineligible for any tax credit, compared to the national average of 9% and a high of almost 23% in Montana.

Pennsylvania. Pennsylvania's tuition and fees for its public and private colleges and universities are significantly higher than the national average, yet the average tax credit per student in the state is slightly lower than the national average primarily because the state has an extensive need-based scholarship program. This state-sponsored scholarship program offsets an individual's eligibility for a tax credit dollar-for-dollar, thereby lowering the state's average tax credit per student.

New York. Despite having the largest state-sponsored student aid program in the nation, New York's students are projected to receive a higher than average tax credit per eligible student. This is primarily because the state relies heavily on its private colleges to provide college opportunity (41% of all enrolled stu-

dents in New York attend a private four-year college), and tuition and fees at the state's private colleges are higher than the national average (based on 1995–96 data). On the other hand, 12% of the state's college students are projected to be ineligible for any tax credit. This is higher than the national average because New York's college population has a high percentage of low income students, and because New York offers extensive need-based financial aid through its Tuition Assistance Program.

Montana. About 23% of Montana's college students are projected to be ineligible to receive either the HOPE or the Lifetime Learning tax credits. This high percentage—the highest of all 50 states—is primarily due to the fact that a large proportion of its college population (38%) is made up of lower and lower-middle income students. However, the average tax credit per eligible student is projected to be higher than the national average because Montana has one of the smallest state-sponsored scholarship programs in the country.

SECTION TWO

Description of State Policy Alternatives

States are currently considering a wide range of responses to the federal tuition tax provisions (see Appendix, Tables 6 and 7, for a summary of policies being considered by each state). This section describes the most significant of these responses, as well as several other state policy options. States could combine several of these policy alternatives, or select one in isolation:

1. Take no action,
2. Change tuition policies,
3. Adjust existing state student financial aid programs,
4. Modify the existing state tax code, and
5. Encourage maximum knowledge and use of the tax benefits.

OPTION 1: TAKE NO ACTION

States do not have to change existing state policies or enact new ones in order for students and their families to benefit from the millions of dollars the federal government is offering through the new tax provisions. Because the new federal law represents a major change in the federal government's approach to financing higher education, some states are waiting to see how the new tax provisions will be implemented. History provides a rationale for this cautious approach; the federal government once before undertook, and later rescinded, a major program to provide financial support for middle income families.[5]

Effect: A decision to *not* act will allow the new law to meet its goal of helping to ease the cost of college for middle income families.

OPTION 2: CHANGE TUITION POLICIES

States can raise tuition at public institutions of higher education, thereby allowing the state or its colleges and universities to "capture" the benefits that the new federal tax credits are designed to provide to students and their families.

Effects: Several states have low tuition levels that may not yield the maximum federal tax credit. If states do not increase tuition, they may be missing the opportunity to shift some costs to the federal government through the federal tuition tax credits. This option would increase the cost of college for low income families and independent students who do not qualify for the tax credits, unless financial aid were increased to meet the full needs of these students.

Option 3: Adjust Existing State Student Financial Aid Programs

Most states have established at least one need-based grant program; many states have more than one. These state grants, although growing in size, constitute a small proportion (on average, 5% or less) of total state support for higher education. There are several alternatives that states are considering in relation to adjusting their student financial aid programs in light of the new federal tax credits:

A. Consider the federal tax credits as income when calculating state student aid eligibility. Including the new tuition tax credits as income would be similar to what occurs now at the federal level, where students and families who receive the earned income tax credit have to count that credit as income when applying for federal financial aid.

Effects: Some students who would have previously qualified for state student financial aid programs would no longer qualify or would qualify for less state aid due to their participation in the federal tax credit program. This could permit the state, at no additional state cost, to concentrate financial aid on those students with more financial need.

B. Create additional financial aid programs that replicate in whole or in part the intent of the new federal tax provisions.

Effects: Creating new state financial aid programs targeted to students and families earning from $40,000 to $80,000 annually could further address the affordability concerns of the middle class. State funding for new financial aid programs, however, would not necessarily add to the benefits of those who qualify for the federal tax credits, because eligibility for the federal tax credits is limited to the cost of tuition and fees *minus* any grants and scholarships received. As a result, new state funding in this area would, in many cases, use state dollars to pay for benefits that students or their families would have received through the federal tax credits.

Option 4: Modify the Existing State Tax Code

A. Conform state income tax code to adopt federal tax credits at state level. States with income taxes can conform their state tax code to allow students and families to claim the same tax credits on their state income taxes as they can on

their federal income taxes.

Effects: Adopting state-sponsored tuition tax credits would provide additional benefits to the middle and upper-middle income students who benefit from the federally sponsored HOPE and Lifetime Learning tax credits. Conforming the state income tax code to the new federal tax credits will result in a loss of state revenue.

B. Conform state income tax code to adopt federal tax deductions at state level. States can conform their state tax code so as to use the federal government's definition of adjusted gross income, thereby allowing student loan interest deductions at the state level. Most states with income taxes use the federal government's definition of adjusted gross income. A handful of states set the state tax rate as a percentage of total federal taxes owed. A few states with income taxes have broad definitions of income with few exclusions, deductions, exemptions, or credits.

Effects: Students of all incomes who borrow are likely to benefit from the new federal deductions for interest on student loans. Conforming the state tax code to the federal government's definition of taxable income would confer these benefits at the state level. Conforming the state income tax code to adopt the federal tax deductions will result in a loss of state revenue.

C. Create a state prepayment or college savings plan. In many respects, the new federal tax credits—particularly the savings provisions—reflect the same set of perceived needs and concerns about affordability that state prepayment and college savings plans sought to address. Forty states now have either a prepaid tuition plan or a college savings plan; some states have both. But some states have neither. The new federal savings provisions provide states with an incentive for creating new prepayment or college savings plans: earnings on deposits are now free from federal taxes until withdrawal. (See Appendix, Table 7, for information about which states have these kinds of programs.)

Effects: One effect of this option would be to confer additional benefits to those students and families who already benefit from the federal tax credits. States without a savings plan miss the opportunity, at no cost, to give taxpayers the chance to save for college at federal expense.

Option 5: Encourage Maximum Knowledge and Use of the Tax Provisions

A. Publicize the availability of the federal tax credits as a means to finance college. Some state policy makers—in Ohio and Massachusetts, for instance—are considering public information campaigns to make their residents aware of the federal tax credits and savings provisions.

Effect: Increased use of the federal tax credits by state residents addresses the concerns of middle income families about college affordability.

B. Provide bridge loans to students. With either the HOPE or Lifetime Learning tax credits, families receive the benefit of the credits only after their taxes are filed, which usually will be six months or more after they complete the semester for which the tax credit was earned. Some state policy makers and institutions are considering filling this gap through offering short-term "bridge" loans, made available at the beginning of the academic year and payable when the tax credit is received.

Effect: Bridge loans could prompt more students and families to use the federal tax credits.

SECTION THREE

Recommendations and Considerations for State Policy

The 1997 Taxpayer Relief Act adds a major new revenue stream to the public financing of higher education. Earlier sections of this paper describe and analyze the new tuition tax credits, savings incentives, and loan interest deductions. State policy responses to this new federal law contain both opportunities and dangers. The major opportunity is that the federal action can prompt states to enhance their own efforts to increase college accessibility for all residents. The major danger is that the neediest current and prospective students may be overlooked. Our recommendations in this section are aimed at enhancing the opportunity and reducing the danger.

The major opportunity is that the federal action can prompt states to enhance their own efforts to increase college accessibility for all residents.

The purpose of the federal initiative is to make college more affordable. Whether that purpose will be achieved depends to a large degree upon state policy—on how each governor and legislature adapt their state's unique policies and practices for financing higher education to the new federal tax provisions. If budget numbers alone were the criterion, then states would no doubt seize the new federal tax provisions as offering an "opportunity" to reduce their commitment to higher education. By increasing tuition or by reducing need-based financial aid or both, states could substitute federal dollars for state dollars, thereby shifting more costs to the federal government. But budget numbers are not the *only* important criterion; accessibility and affordability are critical state policy considerations. It is for this reason that this policy guide offers two fundamental recommendations, on which the following seven specific recommendations are based:

- Governors and legislatures should assure that affordability problems are addressed for all income groups. Indeed, the new federal tax policies create an opportunity for many states to assist middle income families *and* address the financial needs of low income families.

- Governors and legislatures should affirm that any state policies that are adopted in response to the new federal tax provisions *at least* maintain current levels of state support for higher education.

Student financial aid is enormously complex. Over the past 30 years, federal grant programs have primarily supported low income students. Federal loan programs, initially aimed at low income students, have expanded to benefit all

students regardless of family income. During this period, states invested heavily in establishing, expanding and supporting public colleges and universities. In addition to this institutional support, most states maintained or initiated their own student aid programs for low income students. Under most state policies, tuition at public colleges and universities has remained low in comparison to that at private campuses, and—even accounting for need-based student aid—middle and upper income families have been the major beneficiaries of low tuition.

From 1998 to 2002, the new federal tax policies will add $40 billion to the total of federal and state student aid. These tax provisions represent two major shifts in federal policy: (1) the new law provides financial support under the tax code rather than through grant and loan programs; and (2) as this guide reveals, families with annual incomes from $40,000 to $80,000—not low income families—will benefit most from the new law.

Specifically, in response to the higher education provisions of the 1997 Taxpayer Relief Act, states should:

1. Actively inform prospective and current college students and their families about the new federal income tax provisions regarding postsecondary education. States should make information about the new federal law widely available—at a minimum, through public service announcements, high schools and guidance councilors, and employers. States should also seriously consider offering "bridge loans" and other means to encourage their use.

2. Examine public financing of higher education and the state policies behind the numbers. The analysis should include state and federal support, college participation and completion rates by income levels, and state social and economic goals for college education. In particular, each state should:

- Evaluate its own financial aid programs and the financial aid programs of its postsecondary institutions in light of the new federal tax policies. Gaps in college opportunity and options for addressing them should be identified.
- Assure that state-level policies are in place to prevent any tuition increases that are not accompanied by sufficient increases in need-based financial aid to meet the needs of low income students.
- Examine the impact of state and federal policies on *current* and *prospective* student populations. Data should include: student and family

income; the distribution of enrollment in public and private two-year and four-year colleges; and tuition and fees.[6]

- Begin gathering data for long-term analyses. Tax return data after April 1999 should be used to analyze which students and families benefit from the tax credits, the amounts they claim, and changes in claims over time.

3. Conform the state tax code to incorporate the new federal provision for making interest on student loans deductible for state income tax purposes. Students from all income levels are projected to benefit from the new federal deductions for interest on student loans. This action would confer these benefits at the state level. It could also prevent complexity in filing state taxes and promote effective auditing by the state.[7]

4. Do *not* conform the state tax code to accommodate the federal tuition tax credits. Conformation would duplicate at the state level the benefits already afforded to middle income students and their families by the federal tax credits. Conforming the state tax code to the new federal tax credit provisions could also increase the complexity of state income tax returns.

5. Do not increase tuition or fees for the sole purpose of capturing federal revenues. Increasing tuition to capture federal dollars may adversely affect low income populations who are not eligible for federal tax credits.

6. Treat federal tax credits as income for purposes of determining eligibility for state financial aid. By considering these credits as income, states could be shifting a portion of state financial aid to meet the needs of low income students. That is, low income students could benefit from the portion of state financial aid that would otherwise be awarded to those higher income students now served by the new federal tax credits.

7. Seriously consider establishing a state tuition prepayment or savings program similar to those that many states now have in place. Under the new federal program, qualified state savings programs provide significant federal tax advantages to middle income families.

Conclusion

The Taxpayer Relief Act of 1997 provides to eligible students and, in many cases, their families, a wide array of federal income tax benefits, including tax credits, savings incentives, and a student loan interest deduction. This new law represents a dramatic increase in the federal government's investment in higher education; once the new benefits are fully used by taxpayers, the tax provisions are projected to almost equal all other forms of federal student financial aid programs combined. The new law also represents a dramatic shift in *how* the federal government invests in education after high school, for two reasons. First, the new law uses the incentives of the tax code rather than outright grants, scholarships or loans to help students and their families pay for college. As a result, estimates of the cost of the provisions are based not on expected expenditures, but on foregone revenues. Secondly, the new tax provisions are not need-based. In fact, as the analysis in this guide reveals, the primary beneficiaries of the new tax credits and savings incentives are middle income and upper-middle income taxpayers. The student loan interest deduction will most likely benefit students of all incomes.

Governors and legislatures should affirm that affordability problems are addressed for all income groups, and any new state policies at least maintain current levels of state support for higher education.

While the benefits of the new federal tax provisions flow directly to individual taxpayers, the new law has significant implications for state higher education finance. Many states have already begun to consider the implications of the new law for their college-going populations, and to discuss state policy alternatives. This guide recommends that as each state considers *whether* and, if necessary, *how* to adapt its own policies in response to the federal initiative, the governor and legislature should affirm that:

- affordability problems are addressed for all income groups, and
- any new state policies *at least* maintain current levels of state support for higher education.

This guide recommends that each state conduct its own analysis of the effects of the tax provisions on its own current and prospective college-going populations, so that state policy makers can know how citizens are benefiting from the federal tax policies, can identify gaps in college opportunity, and can effectively analyze the options for addressing them.

The overriding purpose of the new federal tax provisions is to make college more affordable. It now depends on state policy makers to ensure that families from all income levels receive assistance as they aspire to one of America's most important goals: sending their children to college.

Appendix

Table 1

Projected HOPE and Lifetime Learning Tax Credit Beneficiaries, By Student's State of Legal Residence

State	*Total Fall Enrollment (1995)*	*Residents Receiving Federal Tax Credits*	*Share of Total U.S. Enrollment*	*Share of Federal Tax Credits to Residents*
Alabama	225,612	199,000	1.6%	1.5%
Alaska	29,348	28,000	0.2%	0.2%
Arizona	273,981	250,000	1.9%	1.9%
Arkansas	98,180	81,000	0.7%	0.6%
California	1,817,042	1,695,000	12.7%	13.1%
Colorado	242,739	224,000	1.7%	1.7%
Connecticut	157,695	153,000	1.1%	1.2%
Delaware	44,037	43,000	0.3%	0.3%
D.C.	77,277	76,000	0.5%	0.6%
Florida	637,303	565,000	4.5%	4.4%
Georgia	314,712	272,000	2.2%	2.1%
Hawaii	63,198	63,000	0.4%	0.5%
Idaho	59,566	52,000	0.4%	0.4%
Illinois	717,854	687,000	5.0%	5.3%
Indiana	289,615	266,000	2.0%	2.0%
Iowa	173,835	154,000	1.2%	1.2%
Kansas	177,643	155,000	1.2%	1.2%
Kentucky	178,858	157,000	1.3%	1.2%
Louisiana	203,935	169,000	1.4%	1.3%
Maine	56,547	51,000	0.4%	0.4%
Maryland	266,310	250,000	1.9%	1.9%
Massachusetts	413,794	393,000	2.9%	3.0%
Michigan	548,339	505,000	3.8%	3.9%
Minnesota	280,816	264,000	2.0%	2.0%
Mississippi	122,690	98,000	0.9%	0.8%
Missouri	291,536	266,000	2.0%	2.1%
Montana	42,674	33,000	0.3%	0.3%
Nebraska	115,178	106,000	0.8%	0.8%
Nevada	67,826	62,000	0.5%	0.5%
New Hampshire	64,327	59,000	0.5%	0.5%
New Jersey	333,831	311,000	2.3%	2.4%
New Mexico	102,405	89,000	0.7%	0.7%
New York	1,041,566	916,000	7.3%	7.1%
North Carolina	372,030	342,000	2.6%	2.7%
North Dakota	40,399	34,000	0.3%	0.3%
Ohio	540,275	493,000	3.8%	3.8%
Oklahoma	180,676	159,000	1.3%	1.2%
Oregon	167,145	151,000	1.2%	1.2%
Pennsylvania	617,759	558,000	4.3%	4.6%
Rhode Island	74,100	69,000	0.5%	0.5%
South Carolina	174,125	154,000	1.2%	1.2%
South Dakota	36,695	31,000	0.3%	0.2%
Tennessee	245,692	217,000	1.7%	1.7%
Texas	952,525	860,000	6.7%	6.7%
Utah	147,324	129,000	1.0%	1.0%
Vermont	35,065	32,000	0.2%	0.2%
Virginia	355,919	329,000	2.5%	2.6%
Washington	285,819	262,000	2.0%	2.0%
West Virginia	86,034	76,000	0.6%	0.6%
Wisconsin	300,223	284,000	2.1%	2.2%
Wyoming	30,176	28,000	0.2%	0.2%
United States	**14,261,781**	**12,900,000**		

Notes: U.S. Department of Education estimates based on state-level enrollment, Pell grant recipient data, national averages of tuition and fees, and the President's fiscal year 1998 budget policy, adjusted for mid-season review re-estimates. Because the department's estimates are based on the 1995–96 national average for tuition and fees for each segment, there are some states for which the estimates are not precise. For example, estimates for California are overstated because 60% of its students are enrolled in public two-year colleges, in which tuition and fees were $900 less than the national average for that academic year. This policy brief recommends that states conduct their own analyses using state-specific, current data (and IRS data when they are available) to develop precise estimates of how citizens are benefiting from the federal tax credits. Totals may not add exactly due to rounding.

Source: U.S. Department of Education, *Digest of Education Statistics*, 1997, Table 193.

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Table 2

Projected Distribution of HOPE and Lifetime Learning Tax Credits, By Student's State of Legal Residence

State	*Estimated Total Tax Credit to Individuals (in 1000s)*	*Total Fall Enrollment (1995)*	*% of Enrolled Students Ineligible for Tax Credits*	*Average Tax Credit per Eligible Student*
Alabama	$140,700	225,612	11.8%	$708.54
Alaska	$19,500	29,348	4.6%	$682.14
Arizona	$176,300	273,981	8.8%	$691.20
Arkansas	$57,000	98,180	17.5%	$708.64
California	$1,195,600	1,817,042	6.7%	$691.86
Colorado	$158,200	242,739	7.7%	$696.43
Connecticut	$107,900	157,695	3.0%	$690.20
Delaware	$30,300	44,037	2.4%	$683.72
D.C.	$53,300	77,277	1.7%	$680.26
Florida	$399,000	637,303	11.3%	$697.52
Georgia	$191,800	314,712	13.6%	$697.79
Hawaii	$44,500	63,198	0.3%	$680.95
Idaho	$37,000	59,566	12.7%	$707.69
Illinois	$484,100	717,854	4.3%	$692.58
Indiana	$187,300	289,615	8.2%	$699.25
Iowa	$108,400	173,835	11.4%	$701.95
Kansas	$109,300	177,643	12.7%	$698.06
Kentucky	$111,200	178,858	12.2%	$708.28
Louisiana	$119,300	203,935	17.1%	$713.02
Maine	$36,300	56,547	9.8%	$701.96
Maryland	$176,000	266,310	6.1%	$690.00
Massachusetts	$276,700	413,794	5.0%	$691.60
Michigan	$355,900	548,339	7.9%	$701.58
Minnesota	$186,400	280,816	6.0%	$701.52
Mississippi	$69,600	122,690	20.1%	$720.41
Missouri	$187,400	291,536	8.8%	$700.00
Montana	$23,300	42,674	22.7%	$712.12
Nebraska	$74,800	115,178	8.0%	$698.11
Nevada	$43,800	67,826	8.6%	$690.32
New Hampshire	$41,500	64,327	8.3%	$688.14
New Jersey	$219,600	333,831	6.8%	$692.60
New Mexico	$63,000	102,405	13.1%	$706.74
New York	$647,000	1,041,566	12.1%	$705.90
North Carolina	$240,900	372,030	8.1%	$693.57
North Dakota	$24,200	40,399	15.8%	$714.71
Ohio	$347,600	540,275	8.8%	$704.87
Oklahoma	$112,200	180,676	12.0%	$710.69
Oregon	$106,500	167,145	9.7%	$697.35
Pennsylvania	$393,600	617,759	9.7%	$695.70
Rhode Island	$48,500	74,100	6.9%	$691.30
South Carolina	$108,400	174,125	11.6%	$697.40
South Dakota	$22,100	36,695	15.5%	$722.58
Tennessee	$152,800	245,692	11.7%	$700.92
Texas	$607,100	952,525	9.7%	$696.51
Utah	$91,200	147,324	12.4%	$706.98
Vermont	$22,700	35,065	8.7%	$700.00
Virginia	$232,000	355,919	7.6%	$693.31
Washington	$184,500	85,819	8.3%	$691.60
West Virginia	$54,000	86,034	11.7%	$709.21
Wisconsin	$200,300	300,223	5.4%	$696.83
Wyoming	$19,500	30,176	7.2%	$692.86
United States	**$9,000,000**	**14,261,781**	**9.5%**	**$698.00**

Notes: U.S. Department of Education estimates based on state-level enrollment, Pell grant recipient data, national averages of tuition and fees, and the President's fiscal year 1998 budget policy, adjusted for mid-season review re-estimates. Because the department's estimates are based on the 1995–96 national average for tuition and fees for each segment, there are some states for which the estimates are not precise. For example, estimates for California are overstated because 60% of its students are enrolled in public two-year colleges, in which tuition and fees were $900 less than the national average for that academic year. This policy brief recommends that states conduct their own analyses using state-specific, current data (and IRS data when they are available) to develop precise estimates of how citizens are benefiting from the federal tax credits. Totals may not add exactly due to rounding.

Source: U.S. Department of Education, *Digest of Education Statistics*, 1997, Table 193.

Table 3

Estimated HOPE Tax Credit Received by Dependent Students, By Taxable Income Levels and Net Tuition

Students and families with taxable incomes of $20,000 or less (represented by double box) will be adversely affected if colleges or universities raise tuition and fees to "capture" the tuition tax credit revenue, without an equal increase in need-based student aid.

		If tuition and fees minus scholarships, grants, and other tax-free educational assistance received by the student is . . .					
*Taxable income**	*Tax Owed in 1998†*	*$0*	*$250*	*$500*	*$1,000*	*$1,500*	*$2,000 and above*
		then the value of the federal tax credit is:					
$10,000	$0	$0	$0	$0	$0	$0	$0
$20,000	$377	$0	$250	$377	$377	$377	$377
$30,000	$1,871	$0	$250	$500	$1,000	$1,250	$1,500
$40,000	$3,371	$0	$250	$500	$1,000	$1,250	$1,500
$50,000	$4,871	$0	$250	$500	$1,000	$1,250	$1,500
$60,000	$6,537	$0	$250	$500	$1,000	$1,250	$1,500
$70,000	$9,337	$0	$250	$500	$1,000	$1,250	$1,500
$80,000	$12,137	$0	$250	$500	$1,000	$1,250	$1,500
$90,000	$14,937	$0	$125	$250	$500	$625	$750
$100,000	$17,737	$0	$0	$0	$0	$0	$0

* Taxable income refers to "adjusted gross income" on federal tax forms.

† Federal tax owed was calculated based on: 1997 tax rates for two parents filing a joint return with two children and standardized deductions.

Table 4

Estimated Benefits of Federal Student Aid and the HOPE Tax Credit, by Taxable Family Income

Two-Year Public Colleges and Universities

Taxable Income	*Pell Grant*	*Loan Subsidy*	*HOPE Tax Credit*	*Total Aid*
$10,000	$3,000	$200	$0	$3,200
$20,000	$3,000	$200	$0	$3,200
$30,000	$2,450	$200	$0	$2,650
$40,000	$950	$200	$550	$1,700
$50,000	$0	$0	$1,250	$1,250
$60,000	$0	$0	$1,250	$1,250
$70,000	$0	$0	$1,250	$1,250
$80,000	$0	$0	$1,250	$1,250
$90,000	$0	$0	$625	$625
$100,000	$0	$0	$0	$0

Average Tuition = $1,500 Total Cost of Attendance = $4,500

Four-Year Public Colleges and Universities

Taxable Income	*Pell Grant*	*Loan Subsidy*	*HOPE Tax Credit*	*Total Aid*
$10,000	$3,000	$875	$0	$3,875
$20,000	$3,000	$875	$0	$3,875
$30,000	$2,450	$875	$550	$3,875
$40,000	$950	$875	$1,500	$3,325
$50,000	$0	$875	$1,500	$2,375
$60,000	$0	$0	$1,500	$1,500
$70,000	$0	$0	$1,500	$1,500
$80,000	$0	$0	$1,500	$1,500
$90,000	$0	$0	$750	$750
$100,000	$0	$0	$0	$0

Average Tuition = $3,000 Total Cost of Attendance = $10,000

Four-Year Private Colleges and Universities

Taxable Income	*Pell Grant*	*Loan Subsidy*	*HOPE Tax Credit*	*Total Aid*
$10,000	$3,000	$875	$0	$3,875
$20,000	$3,000	$875	$0	$3,875
$30,000	$2,450	$875	$1,500	$4,825
$40,000	$950	$875	$1,500	$3,325
$50,000	$0	$875	$1,500	$2,375
$60,000	$0	$875	$1,500	$2,375
$70,000	$0	$875	$1,500	$2,375
$80,000	$0	$875	$1,500	$2,375
$90,000	$0	$875	$750	$1,625
$100,000	$0	$875	$0	$875

Average Tuition = $13,000 Total Cost of Attendance = $20,000

Note: Calculations are for full-time freshmen. Income is defined as adjusted gross income for taxpayers filing jointly with two dependents. Pell grants are for families of four with one child in college. Loan subsidy is based on the maximum subsidized loan for freshmen, $2,625. Eligibility for tax credit is determined by tuition less all grants, scholarships, and other tax-free educational assistance. Tax credit is $0 if family income is less than $30,000 or net tuition is negative. Maximum allowable tax credit is $1,250 for two-year colleges and $1,500 for four-year colleges.

Source: The Brookings Institution.

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Table 5

Estimated Cost of Attendance before and after Enactment of the HOPE Tax Credit, By Taxable Family Income

Two-Year Public Colleges and Universities

Taxable Family Income	*Cost of Attendance before Tax Credit*	*Cost of Attendance as a % of Income*	*Cost of Attendance after Tax Credit*	*Cost of Attendance as a % of Income*
$10,000	$1,300	13%	$1,300	13%
$20,000	$1,300	6%	$1,300	6%
$30,000	$1,850	6%	$1,850	6%
$40,000	$3,350	8%	$2,800	7%
$50,000	$4,500	9%	$3,250	7%
$60,000	$4,500	8%	$3,250	5%
$70,000	$4,500	6%	$3,250	5%
$80,000	$4,500	6%	$3,250	4%
$90,000	$4,500	5%	$3,875	4%
$100,000	$4,500	5%	$4,500	5%

Average Tuition = $1,500 Total Cost of Attendance = $4,500

Four-Year Public Colleges and Universities

Taxable Family Income	*Cost of Attendance before Tax Credit*	*Cost of Attendance as a % of Income*	*Cost of Attendance after Tax Credit*	*Cost of Attendance as a % of Income*
$10,000	$6,125	61%	$6,125	61%
$20,000	$6,125	31%	$6,125	31%
$30,000	$6,125	20%	$6,125	20%
$40,000	$8,175	20%	$6,675	17%
$50,000	$9,125	18%	$7,625	15%
$60,000	$10,000	17%	$8,500	14%
$70,000	$10,000	14%	$8,500	12%
$80,000	$10,000	13%	$8,500	11%
$90,000	$10,000	11%	$9,250	10%
$100,000	$10,000	10%	$10,000	10%

Average Tuition = $3,000 Total Cost of Attendance = $10,000

Four-Year Private Colleges and Universities

Taxable Family Income	*Cost of Attendance before Tax Credit*	*Cost of Attendance as a % of Income*	*Cost of Attendance after Tax Credit*	*Cost of Attendance as a % of Income*
$10,000	$16,125	161%	$16,125	161%
$20,000	$16,125	81%	$16,125	81%
$30,000	$16,675	56%	$15,175	51%
$40,000	$18,175	45%	$16,675	42%
$50,000	$19,125	38%	$17,625	35%
$60,000	$19,125	32%	$17,625	31%
$70,000	$19,125	27%	$17,625	26%
$80,000	$19,125	24%	$17,625	23%
$90,000	$19,125	21%	$18,375	21%
$100,000	$19,125	19%	$19,125	19%

Average Tuition = $13,000 Total Cost of Attendance = $20,000

Note: Calculations are for full-time freshmen. Taxable family income is defined as adjusted gross income for taxpayer filing jointly with two dependents. Pell grants are for families of four with one child in college. Loan subsidy is based on the maximum subsidized loan for freshmen, $2,625. Eligibility for tax credit is determined by tuition less all grants, scholarships, and other tax-free educational assistance. Tax credit is $0 if family income is less than $30,000 or net tuition is negative. Maximum allowable tax credit is $1,250 for two-year colleges and $1,500 for four-year colleges. Cost of attendance equals tuition, required fees, and room and board—minus scholarships, grants, and other tax-free educational assistance received by the student.

Source: The Brookings Institution

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Table 6

Overview of Recent State Activity Related to the Federal Tax Credits and Savings Provisions (1997–98)

State	*Description of Action or Discussion to Date*	*No Action or Discussion to Date*	*No Response to Survey*
Alabama		X	
Alaska	Bill introduced in Legislature creating new student aid program that recognizes tax credit in its eligibility formula. Proposal did not pass.		
Arizona	Lower appropriation to institutions proposed by governor. Proposal not included in budget that passed.		
Arkansas			X
California	Legislative Analyst's Office recommended increasing community college tuition to capture tax credit revenues.		
Colorado		X	
Connecticut		X	
Delaware		X	
D.C.			X
Florida		X	
Georgia			X
Hawaii		X	
Idaho		X	
Illinois		X	
Indiana	Institutions have discussed tuition increases to capture federal tax revenue.		
Iowa		X	
Kansas			X
Kentucky	Enacted Commonwealth Merit Scholarship program and fully funded state's need-based program.		
Louisiana			X
Maine		X	
Maryland	No adjustments planned for tuition or state and institutional aid eligibility. New scholarship created in 1998 for science and technology fields, which, combined with the tax credit, will cover the average cost of tuition at a public two-year or four-year institution.		
Massachusetts	Board considering adopting "Community College Cost Initiative," which will lower net cost for students using federal tax credits. Modifying existing state aid programs.		
Michigan			X
Minnesota	Proposed $500 state tax credit to cover difference in tuition less federal tax credit. Proposal did not pass.		
Mississippi			X
Missouri			X
Montana			X
Nebraska		X	
Nevada		X	
New Hampshire		X	
New Jersey			X
New Mexico	Coordinating board is preparing recommendations for Legislature.		

Table 6 (continued)

Overview of Recent State Activity Related to the Federal Tax Credits and Savings Provisions (1997–98)

State	*Description of Action or Discussion to Date*	*No Action or Discussion to Date*	*No Response to Survey*
New York*	State is considering how to offset state aid with federal tax credits.		
North Carolina	UNC task force is studying tuition policies and plans to discuss response to tax credits.		
North Dakota			X
Ohio	Designing a public information campaign on tax credits to promote adult participation.		
Oklahoma			X
Oregon			X
Pennsylvania			X
Rhode Island		X	
South Carolina			X
South Dakota		X	
Tennessee		X	
Texas	Discussing changes to financial aid programs in the context of tax credit beneficiaries. Legislative committees have been advised to structure new programs to take full advantage of tax credits.		
Utah			X
Vermont			X
Virginia		X	
Washington		X	
West Virginia		X	
Wisconsin			X
Wyoming		X	

* The New York State Higher Education Services Corporation responded to the survey.

Source: SHEEO-sponsored electronic survey of state financial officers, May 1998.

Table 7

Major Non-Need-Based State Aid and Tax Programs

State	*Savings or Prepaid Tuition Plan*	*Broad-Scale Merit Scholarships*	*Tuition Tax Credits or Deductions*	*Likelihood of Conforming State Code to include the New Student Loan Interest Deduction*
Alabama	Prepaid Plan	Proposal before 1998 Legislature	Under consideration	State does not employ a federal starting point
Alaska	Prepaid Plan	Proposed in 1998 Legislature		No state income tax
Arizona	Savings Plan			Good likelihood; state has adopted federal code as of 1/1/97
Arkansas	Neither			State does not employ a federal starting point
California	Savings Plan			Good likelihood; state has adopted federal code as of 1/1/97
Colorado	Prepaid Plan			Strong likelihood; state has adopted federal code as currently in effect
Connecticut	Savings Plan			Strong likelihood; state has adopted federal code as currently in effect
Delaware	Savings Plan	Proposal before 1998 Legislature		Strong likelihood; state has adopted federal code as currently in effect
D.C.	Neither			Fair likelihood; certain state sections conform to the federal code as of 04/11/95
Florida	Prepaid Plan	Yes: Bright Futures		No state income tax
Georgia	Neither	Yes: Hope Scholarship		Good likelihood; state has adopted federal code as of 1/1/97
Hawaii	Examining Feasibility		Under consideration	Good likelihood; state has adopted federal code as of 12/31/96
Idaho	Legislation Pending			Good likelihood; state has adopted federal code as of 1/1/97
Illinois	Savings and Prepaid Plans		Under consideration	Strong likelihood; state has adopted federal code as currently in effect
Indiana	Savings Plan			Good likelihood; state has adopted federal code as of 1/1/97
Iowa	Savings Plan			Good likelihood; state has adopted federal code as of 3/20/96
Kansas	Examining Feasibility of Savings Plan	Proposed in 1998 Legislature		Strong likelihood; state has adopted federal code as currently in effect
Kentucky	Savings Plan			Fair likelihood; state has adopted federal code as of 12/31/95
Louisiana	Savings Plan	Proposed in 1998 Legislature		Strong likelihood; state has adopted federal code as currently in effect
Maine	Savings and Prepaid Plans			Good likelihood; state has adopted federal code as of 12/31/96
Maryland	Prepaid Plan	Proposed in 1998 Legislature		Strong likelihood; state has adopted federal code as currently in effect
Massachusetts	Prepaid Plan; Legislation Pending for Room and Board Savings Plan			Strong likelihood; state has adopted federal code as currently in effect
Michigan	Prepaid Plan			Good likelihood; taxpayer has option of using current federal code or code effective 1/1/96
Minnesota	Savings Plan			Good likelihood; state has adopted federal code as of 12/31/96
Mississippi	Prepaid Plan	Yes		State does not employ a federal starting point

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Table 7 (continued)

Major Non-Need-Based State Aid and Tax Programs

State	*Savings or Prepaid Tuition Plan*	*Broad-Scale Merit Scholarships*	*Tuition Tax Credits or Deductions*	*Likelihood of Conforming State Code to include the New Student Loan Interest Deduction*
Missouri	Legislation Pending, Prepaid Plan		Under consideration	Strong likelihood; state has adopted federal code as currently in effect
Montana	Savings Plan			Strong likelihood; state has adopted federal code as currently in effect
Nebraska	Examining Feasibility	Proposed in 1998 Legislature		Strong likelihood; state has adopted federal code as currently in effect
Nevada	Prepaid Plan			No state income tax
New Hampshire	Savings Plan			Weak likelihood; state complies with federal code on interest and dividends only
New Jersey	Savings Plan			State does not employ a federal starting point
New Mexico	Savings Plan			Strong likelihood; state has adopted federal code as currently in effect
New York	Savings Plan	Proposed in 1998 Legislature		Strong likelihood; state has adopted federal code as currently in effect
North Carolina	Savings Plan			Good likelihood; state has adopted federal code as of 3/20/97
North Dakota	Examining Feasibility			Strong likelihood; state has adopted federal code as currently in effect
Ohio	Prepaid Plan			Strong likelihood; state has adopted federal code as currently in effect
Oklahoma	Legislation Pending for Prepaid Plan			Strong likelihood; state has adopted federal code as currently in effect
Oregon	Neither			Fair likelihood; certain state sections conform to the federal code as of 12/31/96
Pennsylvania	Prepaid Plan			State does not employ a federal starting point
Rhode Island	Savings Plan			State automatically adopts federal code
South Carolina	Prepaid Plan	Yes: STAR		State has adopted federal code as of 12/31/96
South Dakota	Savings Plan			No state income tax
Tennessee	Prepaid Plan			Weak likelihood; state complies with federal code on interest and dividends only
Texas	Prepaid Plan	Proposed in 1998 Legislature		No state income tax
Utah	Savings Plan			Strong likelihood; state has adopted federal code as currently in effect
Vermont	Savings Plan			State automatically adopts federal code
Virginia	Prepaid Plan	Proposed by governor		Strong likelihood; state has adopted federal code as currently in effect
Washington	Prepaid Plan			No state income tax
West Virginia	Prepaid Plan			Good likelihood; state has adopted federal code as of 1/1/97
Wisconsin	Prepaid Plan		Proposed in 1998 Legislature	Good likelihood; state has adopted federal code as of 12/31/96
Wyoming	Prepaid Plan, no new contracts			No state income tax

Sources: From telephone interview with Cathy Tyson, Director, The College Savings Plan Network, June 3, 1998; National Conference of State Legislatures, Chronicle of Higher Education, Federation of Tax Administrators.

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Endnotes

[1] U.S. General Accounting Office, *College Savings Information on State Tuition Prepayment Programs* (Washington, D.C.: Government Printing Office, 1995).

[2] U.S. General Accounting Office, *Report on Student Debt Burdens* (Washington, D.C.: Government Printing Office, 1998).

[3] These figures are based on enrollment, income and tuition data from the 1995–96 academic year and on projections provided by the U.S. Department of Education (see Appendix, Tables 1 and 2).

[4] New York, for instance, provides its residents with need-based financial aid through its Tuition Assistance program. Under this state entitlement program, which costs about $630 million annually, New York families with a dependent student enrolled in a four-year public college would not be eligible for the maximum HOPE tax credit unless their taxable income is between $45,000 and $80,000. Based on national averages, most families would be eligible for the full HOPE tax credit if their annual taxable income is between $40,000 and $80,000. In response to this situation, the New York State Higher Education Services Corporation has recommended studying whether changes can be made in the state program so that federal funds can be used rather than state funds.

[5] In 1978, President Carter worked to develop and pass the Middle Income Student Assistance Act (MISAA). The plan increased the maximum income allowable to receive a Pell grant, and expanded eligibility for and removed the income ceiling from subsidized student loans. The interest rate was such a bargain that *House and Garden* magazine printed an investment article, "How you can make a substantial profit from a student loan." Federal costs for the program soon exploded, and three years later, in 1981, Congress instituted a needs test for the guaranteed student loan program, whereby students with family incomes above $30,000 were limited to borrowing no more than the difference between their educational costs and their expected family contribution.

[6] For example, the Minnesota Higher Education Services Office has studied the interaction of federal Pell grants, Minnesota state grants, and the federal HOPE tax credit. Their analysis used current academic year tuition and fee data and the Minnesota living and miscellaneous expense allowance, and eligibility requirements for state-sponsored scholarships to calculate how the cost of attendance is shared by the taxpayer (through federal and state financial aid), the student, and the family.

[7] This recommendation is directed to those states that generally conform their state tax codes to federal deductions of income. Those states that have broad definitions of income (with few exclusions, deductions, exemptions, or credits) should not conform to the federal tax code.

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